Ontario
Economic
Council

81 Wellesley Street East
Toronto, Ontario
M4Y 1H6

(416) 965-4315

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TORONTO, December 13 -- Canadian money and the limitations of domestic capital markets have helped finance increasing foreign control and ownership of Canadian industry, says a report released today by the Ontario Economic Council.

Better credit ratings, lower cost of funds and earnings generated by Canadian subsidiaries are among the advantages held by foreign bidders when acquiring, or expanding, Canadian operations, says Professor John C. Pattison in his study: Financial Markets and Foreign Ownership.

The 143-page study examines financial techniques and regulations built into Canadian capital markets, which have exposed weak domestic industries to foreign takeover.

High interest rates and tight credit conditions, for instance, can cripple normally healthy Canadian businesses, Pattison says, but have little, if any, effect on the expansion of foreign subsidiaries in Canada. Parent companies have access to the retained earnings of Canadian subsidiaries, can delay payment of accounts receivable, defer collection of dividends, transfer funds borrowed at lower cost and have larger pools of capital available through a greater range of intermediaries, less restricted by government regulation.

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As for foreign-owned firms in Canada, Pattison says it seems likely that they can command more resources ~~that~~ than most domestic firms and have more options for finance, production, marketing and distribution.

The author points out that though accumulations of capital in Canada may be sufficient to block foreign acquisitions, these funds are mainly controlled by institutions prevented from making certain equity investments.

In comparison with other countries, he says, "the structure of Canadian financial markets appears to be weighted in favour of less risky, lower-yielding assets and against equity investment."

Professor Pattison notes, too, that liquidity problems of Canadian stocks could be a deterent to purchases by institutions of blocks large enough to prevent an offshore takeover.

Since much of Canadian industry is foreign-owned, these controlling blocks are not publicly traded, creating a less liquid market for the remainder. Also, stocks of many large Canadian companies are listed in London or New York, where it is easier and cheaper to dispose of big blocks to foreign buyers.

Another liquidity snag arises from the comparatively few Canadian institutions, unlike the U.S. or European countries, trading, or controlling, most of the big block trades; lack of buyers and sellers can cause wide price variations.

The Foreign Investment Review Agency has the final word on non-resident acquisition approval, but according to Pattison, it screening methods are "crude."

FIRA's latest annual report shows that during the 12 months ending March, 1978, acquisitions involving Canadian-controlled firms jumped almost 50 per cent. Only 4.4 per cent of takeover bids were rejected, compared with 11.5 for the previous year.

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This study was prepared under the auspices of the Ontario Economic Council, established in 1962 as a public policy institute. The Council undertakes research and policy studies to encourage the optimum development of the human and material resources of Ontario and to support the advancement of all the sectors of the Province. The Council achieves these goals by sponsorship of research projects, publication of studies, and organization of the Outlook and Issues conferences and seminars which are open to the public.

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NOTE: A list of persons to contact for further information, a brief biographical sketch of the author and a selection of quotations from the study are attached.

FOR FURTHER INFORMATION CONTACT:

Robert F.M. Osmond, public relations counsel, (416) 481-4438.
Professor John C. Pattison, University of Western Ontario
(519) 679-3358, or, (519) 472-2924.
Lorie Tarshis, Research Director, Ontario Economic Council,
(416) 965-4315.

AUTHOR'S BIOGRAPHICAL SKETCH:

John Pattison is an assistant professor at the School of Business Administration, University of Western Ontario. He has a B.A. and M.A. from the University of Western Ontario and Ph.D. from the London School of Economics. He is the author and co-author of more than 25 publications in the field of economics and has presented speeches and papers to learned societies and universities in Belgium, Canada, France, the United Kingdom and the United States.

FINANCIAL MARKETS AND FOREIGN OWNERSHIP (143 pages) is available only at the Ontario Government Bookstore, 880 Bay Street, Toronto, Ontario M7A 1N8. Price: $2.50. A cheque, or money order, payable to the Treasurer of Ontario must accompany all mail orders.

OTHER RESEARCH REPORTS prepared for the Ontario Economic Council can be obtained from the University of Toronto Press, 5201 Dufferin Street, Downsview, Ontario M3H 5T8; at major booksellers; or, from the Ontario Government Bookstore at the address above.

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SELECTED QUOTATIONS:

"In consequence, many observers have noted that Canada does not have a problem of foreign control so much as a problem in generating domestic control. Moreover, many policies on foreign ownership have an impact on financial markets, and the extent of foreign control could well alter our traditional view of capital markets and financial policy." (Pg. 2)

"Canadian subsidiaries may be influenced only indirectly, if at all, by the workings of Canadian monetary policy. Their capital requirements may be supplied either by their foreign parent companies or by ploughing back of their own earnings and deferring the payment of dividends to their parents. This gives these companies a decided advantage over their domestic competitors in Canada who must look to the security markets and to the commercial banks to meet their needs for capital ... The activities of the weaker credit risks, who are more likely to be the smaller businessmen, are apt to be restricted to a greater extent than those of large concerns, including subsidiaries of foreign companies." (Pg. 3)

"Of the reports mentioned above, only Walter Gordon's Royal Commission on Canada's Economic Prospects tried to put together some statistics and facts, rather than simply making assertions, and that work is currently twenty years old. Furthermore, many of the statements made in all these reports are vague and suggestive rather than substantive." (Pg. 5)

"Another difficulty in generalizing about the capital market is that the financial process requires assumptions and forecasts about the economic future, for example interest rates, and about the longer-term prospects for borrowers. For many struggling firms the future is very uncertain, and the statistics on bankruptcy and on the longevity of new companies may not be encouraging. Different lenders will have varying opinions either about lending at all or about the risk premium to be paid. Where a number of prices exist for the same good, economists are usually suspicious about inequity and inefficiency. But it is important to note the lack of experience in lending to often unique borrowers. If there

are few lenders in a field, or few specializing or knowledgeable about intricate, technologically advanced, or uncertain industries, Canadian financial markets may not generate enough competition to give the lowest interest rate on loans." (Pg. 11)

"One important distinction, which should be made here even though it verges on the microeconomic, is that the institutionalization of investment has proceeded further and more quickly for financial claims than for equity investments since many institutions (such as banks, life insurance companies, and other financial intermediaries) in Canada have restrictions on the type or amounts of equities that may be acquired. Banks are important in the financial development of a country, but their relative importance declines as new institutions develop. Goldsmith also noted that foreign financing has played a substantial role in most countries' economic development." (Pg. 17)

"Neufeld (1972) has cited many examples of inadequate competitiveness in the development of Canadian capital markets. For example, in 1927, 60 per cent of bond underwriting was done by five dealers and one bank (509). Other evidence is contained in the 1964 Report of the Royal Commission on Banking and Finance, which made some particularly damaging comments on the structure of underwriting syndicates, a matter of provincial responsibility. Indeed, a Montreal stockbroker has linked the restrictiveness of the financial community directly to the state of foreign ownership and control in Canada: 'the foreign ownership of Canadian industry and the sources of production in Canada are the direct result of the closed cartelized financial community and the cartelized banking system' (Lafferty, 1975, 30-1)." (Pg. 26)

"In many respects, Canadian-controlled and foreign-controlled firms showed different financial structures and performance. CC firms were generally the weaker and had fewer options for raising and channelling funds than did FC firms. The financial position of most industry groupings has deteriorated in recent years for both CC and FC firms. Since all these firms will attempt to raise funds in the market or borrow from banks, it is a source of conern that CC firms are weaker. There seems little doubt from talking to lenders and borrowers that FC firms are generally better credit risks and better able to provide funds for expansion." (Pg. 53)

"It is often asserted that large government financial requirements drive private borrowers out of the market or crowd them out of financial markets with high interest rates, so that the real growth of the private sector relative to the government sector is curtailed. This effect has been found to occur in the United States (using large econometric models as well as less sophisticated techniques). The same effect may exist in Canada. If so, it is more likely that Canadian-controlled firms will suffer rather then subsidiaries, which have many financing alternatives. It is also popularly believed that Canadian entrepreneurs can easily expand by selling control abroad when they cannot obtain financing in Canada." (Pg. 72)

"Consequently, it seems not unlikely that the federal government's financial operations - the financing of fiscal policy crowding out private borrowers in Canadian capital markets - is partly responsible for a small element of foreign direct investment. The statistics indicate the presence of the effect, but the over-all quantitative influence is not great." (Pg. 73)

"The Foreign Investment Review Agency screens takeovers to assess their desirability, albeit crudely, leaving many questions unanswered. In Europe, not only are there governmentally imposed restrictions on takeovers but various techniques have been used by industry and bankers to regain control. In Switzerland many firms have ensured that at least 50 per cent of their shares are in a form that can only change hands with the approval of the directors. In Germany a number of firms have altered their voting rules so that, irrespective of the holdings of a shareholder, he is entitled to vote a maximum of 5 per cent (or some other small number) of total voting rights. Foreign ownership is not discouraged, but foreign control is not possible. One company which followed this technique did not have a shareholder with more than 3 per cent of the equity but felt that such a rule was necessary to preserve the independent character of the firm." (Pg. 79)